RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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August 19, 1977 **LETTER 706**

Aug. 5, DJIA 888.69; PTI 883; A-D Ratio –18.69
Aug. 12, DJIA 871.10; PTI 864; A-D Ratio –19.06

THE AVERAGES: Everybody talks about the Averages, but very few people understand how they work. According to Dow's Theory, bull market corrections (and we are experiencing one now) tend to retrace one-third to two-thirds of the previously **uncorrected** primary advance. I no sooner started to write this piece when I received a letter from my old friend, "Mike" Shumate (Mike co-authored the classic book, "Making the Dow Theory Work," published in 1940). Here's what Mike wrote:

"No doubt remains that we are well into a big secondary reaction. It is time, I think, to lay out the figures."

	INDUSTRIALS	TRANSPORTS
Last High	1,014.79 (9-21-76)	246.64 (5-18-77)
Bottom of previous reaction	**784.16 (10-1-75)**	**149.38 (9-16-75)**
2nd Bull Leg	230.63	97.26
Retracement of 1/3 reaches	937.92	214.22
Retracement of 1/2 reaches	899.58	198.01
Retracement of 2/3 reaches	861.04	181.80

"The next obvious note is that the two averages are badly out of gear. The Industrials have almost reached a 2/3 retracement. The Transports, meanwhile, have not yet hit the 1/3 level.

*"Robert Rhea's 'Story of the Averages' shows how vague these situations can be. For example, we can **not** count on a rally in the Industrials from the 861 level. We can, however, feel that the probabilities favor a resumption of the primary upturn in the reasonably near future. The fundamental relationships of price/earnings ratios, and of dividend yields, are still predominantly bullish."*

I might add that in the past there have been reactions that have wiped out over 100% of the previous bull market rise in a single Average. And there have been other reactions in which one (or even both) Averages have failed to correct as much as one-third of the previous bull market advance. Thus, it is conceivable that **this** reaction could end with Industrials below 800 and with Transports still above their one-third correction level of 214.22.

Question: At what point or level would you state that we are in a bear market?
Answer: As explained in the last Letter, bear market signals are only valid when they are given **following a bull market's speculative third phase.** In my considered opinion, this bull market has not yet seen its third phase. Therefore, I foresee no primary bear market ahead.

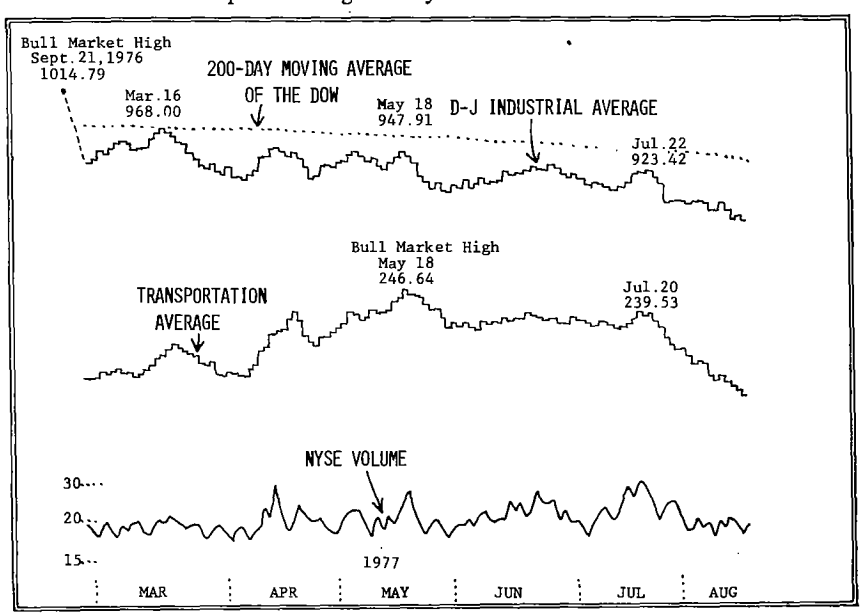
It is well to remember that it is in the third or final phase of a bull market when stocks are **distributed** en masse to the public. And it is only **after** stocks are distributed to the public that a true bear market starts. That is why it is so important to wait for the completion of the bull market's third phase before turning bearish on the primary trend.

THE MARKET: The Dow has now dropped to its lowest level since January 2, 1976, on which date it closed at 858.71. That point is of no great significance, but it does help to orient us as to where we are and where we have come from. Of much more importance is the bull market's **last** reaction low. That low was 784.16, recorded on October 1, 1975.

It is most unusual for a bull market correction to wipe out all of a preceding primary advance. But, for the sake of argument, if the Dow did break 784.16 that's what would have occurred. I put the odds on such an event happening at about 50/50. I give it that good a chance because (1) I do not see any great fear being generated yet, and (2) because a breaking of Dow 800 would be a real surprise to Wall Street, and the market has a perverse way of providing us with surprises.

As you can see via the page 1 chart of the Averages, the Transports have been making up for lost time. Since their May 18 bull market high (246.64), the carriers have given up more than half their gains since last October's low of 203.85. Technically, as long as the Transports hold above 203.85, a downside non-confirmation will be in effect (Industrials have long since broken below their comparable October low).

I am asked what I would think if Transports totally confirmed by smashing 203.85. If that occurred, I would be prepared for a violent downside selling climax, but I would **not** announce that a primary bear market had started (despite the mechanical appearance of a "bear signal"). The reason, and I will repeat this again, is because it would all be occurring during the bull market's *second phase.* It's the action in the late part of the third phase that gives way to the bear.



From the standpoint of my subscribers and myself, this is all (happily) an academic study. It's academic because we are out of the market and watching the whole performance with our assets basically in money instruments such as bonds, notes, bank accounts, bond funds, and what have you.

The Advance-Decline Ratio recorded a 1977 low of minus 20.77 on April 4. It then gained 3.58 points, rising to its July 22 bull market peak of minus 17.38. As of this writing, the A-D has lost about half of its 1977 gains. The fact that the A-D still retains any gains at all (versus a net loss for the Dow) shows us how strong the Relative Strength of the A-D has been. Nevertheless, the A-D looks toppy now, but it remains to be seen whether it will move down with a vengeance or whether it will continue to resist.

Conclusion: Wall Street and the public mistakenly (but understandably) get more bearish as the market goes down. But it is well to remember that every 10 points down is 10 points nearer the final bottom. Hopefully, we will get that "bargain-basement, ideal bottom" that we are all waiting for. We're not there yet, in my opinion. When we are there, few, very few people will be tempted to buy stocks. The reason: because fear will rule, and on Wall Street an ounce of fear usually overrules a pound of intelligence and common sense.

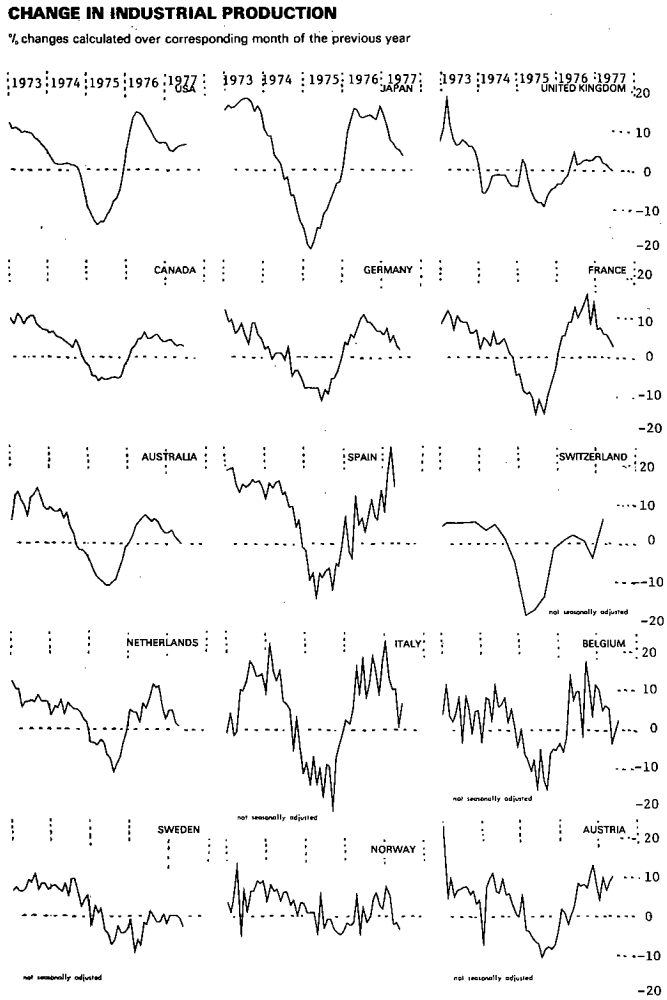
THE PICTURE: What is happening here in the US is now happening around the world. It's economic stagnation with indications of impending recession. Interestingly, a current CIA report notes that Russia and the Communist nations are also suffering from stagnation. If so, the world picture is complete–a global slowdown.

I include this chart courtesy of *Capital International SA*, 15, rue du Cendrier, CH 1201 Geneva, Switzerland. The chart shows the changes in industrial production (year to year basis) of the 15 major economies of the Free World. Of these 15, I count one (Switzerland) in a definite uptrend. I count two (Spain and Austria) in expanding to neutral trends. And the other 12 I put in the neutral to downtrend category.

Actually, as long as an index is above zero, the given nation's economy is expanding. But a downward pointing index means the expansion is losing momentum. Thus Britain and Australia are at approximately zero growth, while Sweden and Norway are actually contracting. Japan, Canada, Germany, France, Australia, and the Netherlands appear on the verge of breaking below zero, thus going into a net contracting phase. In all, it's not an inspiring picture for the economies of the Free World.

Ever since last September, while most of the investment fraternity was laughing away (or explaining away) the long, relentless slide in the D-J Industrial Average, I have been saying that "something is very wrong." Despite strength in the A-D ratio, the Utility Average and the Transportation Average, the Dow has followed its dreary downward path.

Every market provides its own foolers, and in Wall Street the popularity in an indicator breeds failure and later contempt. The "popular indicator" for 1977 was the Advance-Decline ratio. It was popular because it was telling a story that everyone (who owned stocks) wanted to hear. But even as the much-maligned Dow headed down, the A-D ratio (along with the Transports and Utilities) worked higher. I commented that we were witnessing one of the longest and most extraordinary



divergences in the history of the stock market. I also noted that ultimately (as they always have in the past) all segments of the market would get "in gear." It was also noted that the indicator that was most persistent (i.e., the indicator in the strongest trend) would take all the others with it.

As it happened, the Transportation Average topped out on May 18 at 246.64. The Utility Average recorded its high on July 22 at 118.67. The A-D ratio hit its high on July 22 at minus 17.38. On July 27 the Industrial and Transportation Averages simultaneously broke their preceding lows on authoritative volume of 26 million shares. I took this as an important "signal." From that point the various segments of the market tended to move together, and the direction was down.

In the last report I explained in detail what I thought could be happening and what I expected during the period ahead. I want to amplify this a bit in the current report. First, I think the market and the accompanying industrial production charts are telling us that the world is going into a period in which it will have to **choose** between more inflation or extended stagnation. And at this point, there is no guarantee at all that increased inflation will take up the economic slack and produce a new boom.

Europe is now heading into a period of high unemployment and low productivity. Business across Europe is sluggish, and in many nations (France, Italy, Spain) the political and social conditions are unstable. Competition for business is heating up in Europe, and the various nations are now competing for exports (often with the help of competitive devaluations).

In the US most corporations are not moving towards capital expansion. And the reason is clear–they are not receiving attractive returns on their investments. The fact is that corporations are finding it more desirable to buy out other companies or to merge. The rationale is that US stocks, in general, are cheap on a book value basis, and it's preferable to take over the other man's assets, rather than expand your own.

The US consumer is now heavily bought up, and he is being squeezed by high prices. His natural inclination is to hold off or pay off, rather than go over his head into further debt. Thus these two forces (corporate conservatism and consumer caution) are producing stagnation.

Personally, I believe a third phenomenon is operating to slow the economy, and it's simply the desire to "hang on." I see it and I hear it from subscribers and friends from one end of the nation to the other. People are just not excited about making "a big killing" today. They are interested in **income, making ends meet, and keeping what they have**. The old dreams of perpetual growth and the ever -rosy future are dormant at this time.

The businessman and the fellow with capital feel (and rightly so) that they are in a deadly struggle with their Government and with inflation, a struggle to keep what they have and to keep what they earn. Almost weekly we read that the IRS wants to expand its tax horizon to include this or that new category. And this simply intensifies the fears of the great majority of middle and upper class Americans who are "digging in and hanging on."

Worst of all, I feel, is that the segment of society that is being hurt most (destroyed is a better word for it) is the very productive ***middle class***. The middle class American does not get the benefits of the handouts and aids that the poor receive. Nor does the middle class citizen get the top legal advice, the tax advantages, and the income and investment opportunities that the rich get. If this trend towards destruction of the middle class is not reversed, I think the very foundations of the free enterprise system will be endangered.

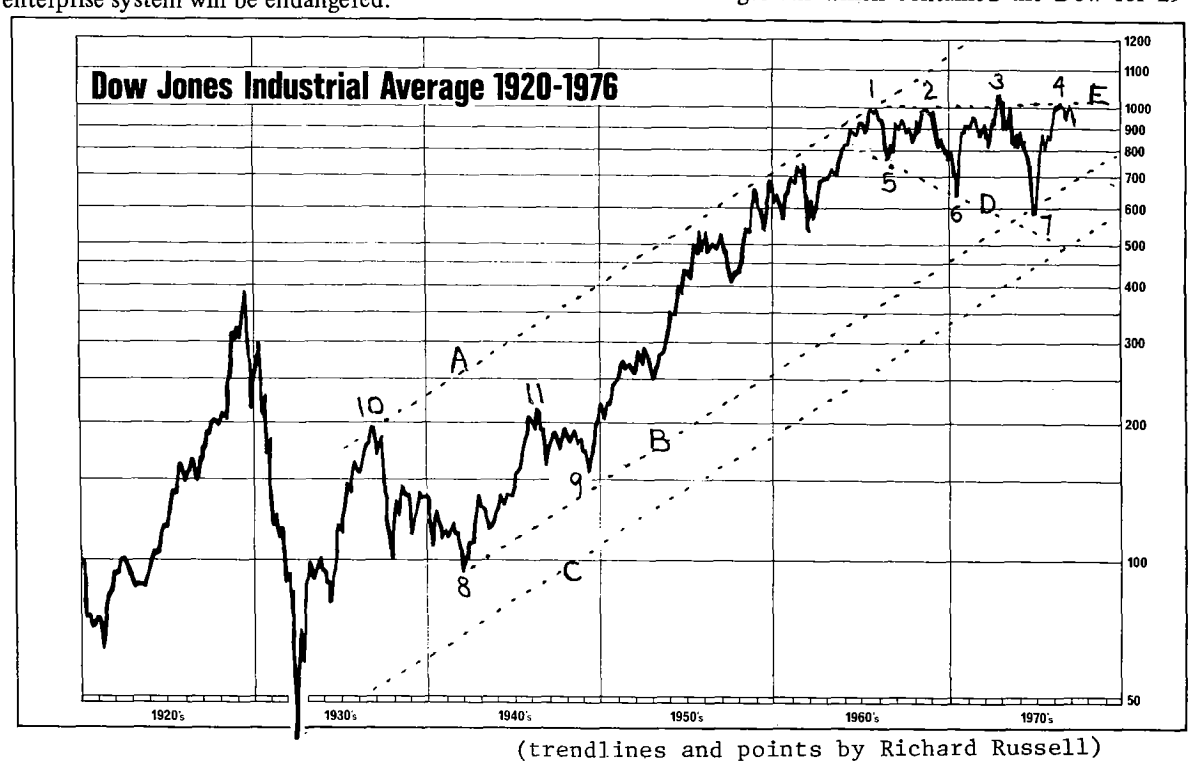
FAILURES: A great deal has been written about "technical successes" in the market. We hear that "this stock broke out of a head-and-shoulder base," or we hear that "the Dow bettered a previous peak." But not too much is written or understood about technical failures. Yet a study of technical failures, particularly *trendline failures*, can be most instructive. I have wanted to do this piece for some time. And with so many wondering about the direction of the long-term trend, this seems a good time to include this study.

I know that the subject matter in the 1977 Letters has been rather difficult to assimilate, and I am referring to the discussions of Elliott and Kondratieff. But there is a third way of looking at the long-term trend, and I want to cover it in this report. The study has to do with the success or failure of the price movement in holding to a trendline.

This study requires that we use charts drawn to semi-logarithmic scale. On semi-log (sometimes called ratio) scale, all movements are expressed in terms of *percentages* of rally or decline. For instance, a rise in the Dow from 50 to 100 will take up the exact same vertical distance on a semi-log chart as a rise from 240 to 480. The reason is that both rises represent an advance of exactly 100%.

By the same token, all *trendlines* on a semi-log chart portray a *uniform rate of rise or decline* (another term would be a uniform rate of growth or contraction). For instance, if we draw a trendline showing a rate of rise equal to 10% per year, as long as the price movement holds to or above that trendline, we can say that the growth rate is holding at a constant figure. And as soon as that trendline is violated, we can say that the growth rate has terminated.

Therefore, when trendlines are properly drawn on a ratio chart, it is possible to make many inferences. I have included a chart of the Dow going back to 1920 (chart courtesy of *Warren, Cameron Co. Ltd.*, Church House, Church St., Godalming, Surrey, England). Note that I have drawn a rising trendline (A on chart) connecting the 1937 bull market top (at 10) and the 1966 bull market top (at 1). That trendline represents a peak rate of growth which contained the Dow for 29 years. Then I drew a *parallel* trendline starting from the 1932 bear market low. That trendline is labelled C on the chart. Next I drew a third parallel trendline starting from the 1942 low at 8 on the chart. Now let's see what conclusions can be drawn.



(trendlines and points by Richard Russell)

Following the 1937 bull market peak (10), the Dow crashed to the 1942 low 92.92 (8 on chart). In retrospect, we see that point 8 (1942) held well above trendline C. Looking at the

picture here in the year 1977, we can say that it was a hopeful sign that the Dow refused to decline to the point where it touched trendline C. That "failure" to meet trendline C was a great point of strength for the Dow.

Next, the Dow advanced (1942 to 1946 bull market) to 212.50 at point 11. Following the 1946 top (11), the Dow smashed down again, and that long, drawn out decline ended at the 1949 bear market low of 161.60 (9 on the chart). But note that at the 1949 low (9) the Dow "refused" to meet trendline B. This demonstrates (in retrospect) tremendous strength from the standpoint of a "downside failure."

It is also of interest to note the rising bottoms on the Dow, those of 1932 (41.22), 1942 (92.92) and 1949 (161.60). This ascending series, spread over *17 years*, implied great upside strength to come. It is a fascinating fact that the bull market of 1949 to 1966 also consumed exactly *17 years*, and thus the two time spans add up to the Fibonacci number 34.

At the 1949 Dow low of 161.60 (9), a great bull market was born. By early 1950 the Dow had bettered both its 1937 and 1946 bull market highs. By 1954 the Dow bettered its fabled 1929 high. At point 1 in February, 1966, the Dow struck an historic peak of 995.15. That proved to be the bull market top. The Dow then broke to a late 1966 low of 744.21 (point 5). A new advance carried to a high of 985.21 (2) in 1968. A second slump took the Dow to the late 1970 low of 631.16 (6).

I have drawn descending trendline D which connects points 5 and 6 on the chart. Following the 1970 low at 6, the Dow rallied strongly to the 1973 peak of 1051.70 (3 on the chart). This represented the **third failure** by the Dow to push *decisively* above the 1000 zone (trendline E). The aftermath was a Dow crash to a final bear market low of 577.60 in late 1974 (point 7).

Now observe the dramatic (downside) failure of the Dow (at point 7) to touch declining trendline D, the trendline which connects the 1966 and 1970 lows. Although the Dow did not meet trendline D, it did touch trendline B at the 1974 bottom. This was the first time the Dow had made contact with trendline B since 1942.

Thus, we had a most extraordinary situation in that the Dow had reached a "logical stopping place" at rising trendline B, yet it had clearly failed to contact declining trendline D. The upside explosion which followed carried the Dow back to upper trendline E in the 1000 zone. Incredibly, the Dow rose from point 7 (577.60) to upper trendline E in less than two years.

All of which takes us to the present. What can we look for now? Note that trendline B, starting at the 1942 low, touched the 1974 low and theoretically would meet the Dow today at *about 700*. The next statement may sound absurd from the standpoint of the investor, but from the standpoint of the safety of the nation and the future of the free enterprise system it is not. As long as the Dow holds above Trendline B, we can say that the situation is **long-term bullish**. Trendline B began in 1942; it contained the Dow during the worst market crash (i.e. 1973-74) in a generation. And so far it has contained the Dow through Vietnam, Watergate, droughts, inflation, freezes, the severest recession (1975) since the 1930's, and most recently a gathering energy crisis.

The test which lies ahead is clear. Points 1,2,3 and 4 give mute testimony to what must be considered the greatest overhead resistance zone in the history of the stock market. The four peaks are loosely connected by trendline E. So far, the Dow has failed to rise decisively above trendline E. On the other hand, the Dow has also failed to penetrate decisively below trendline B. Sooner or later it must do one or the other. My personal belief is that the Dow will finally push above trendline E. But as always, it will do it (1) when least expected, and (2) on its own good time!

Many Elliott Wave followers believe that the major advance which began at the 1974 lows represents the beginning of a rising Wave V in the great Elliott bull market that began at the 1932-33 bottom. If true, then there is a chance that the final upthrust of Wave V could approach or actually touch rising trendline A. That would entail the Dow moving up to around 2400 by the early 1980's. Such a move would certainly finish off the huge super-cycle and ultimately give way to a bear market which would serve to correct the entire upthrust since 1932-33.

Could such a massive rise take place? I honestly don't know, but I present it as a most fascinating technical possibility. Actually, I am **more interested** at this time in showing the great technical significance of the December, 1974 low on the Dow. My own belief is that 1000 will be substantially bettered before the 1974 low of 577.60 is ever broken.

MOVING AVERAGES: In the last report I included a chart showing the three moving averages (MA's) of the Dow, the 4-week, the 13-week and the 50-week. The major signals are given when the 13-week or intermediate term MA crosses above or below the 50-week or long term MA.

The chart on page 5 is simply a variation of the previous Dow MA study. Instead of showing the Dow and its three MA's, this chart shows the Dow (weekly) and a line which represents the **spread** between the 13-week and the 50-week MA. When the 13-week MA crosses bullishly above the 50-week MA, the differential line (DL) rises above zero. When the 13-week MA drops bearishly below the 50-week MA, the DL indicates this action by sinking below zero.

Personally, I find this a most interesting and valuable study. It is purely a technical study in that we are trying to draw inferences about the market by studying HOW this line acts. I have drawn a few basic observations about the DL and here they are.

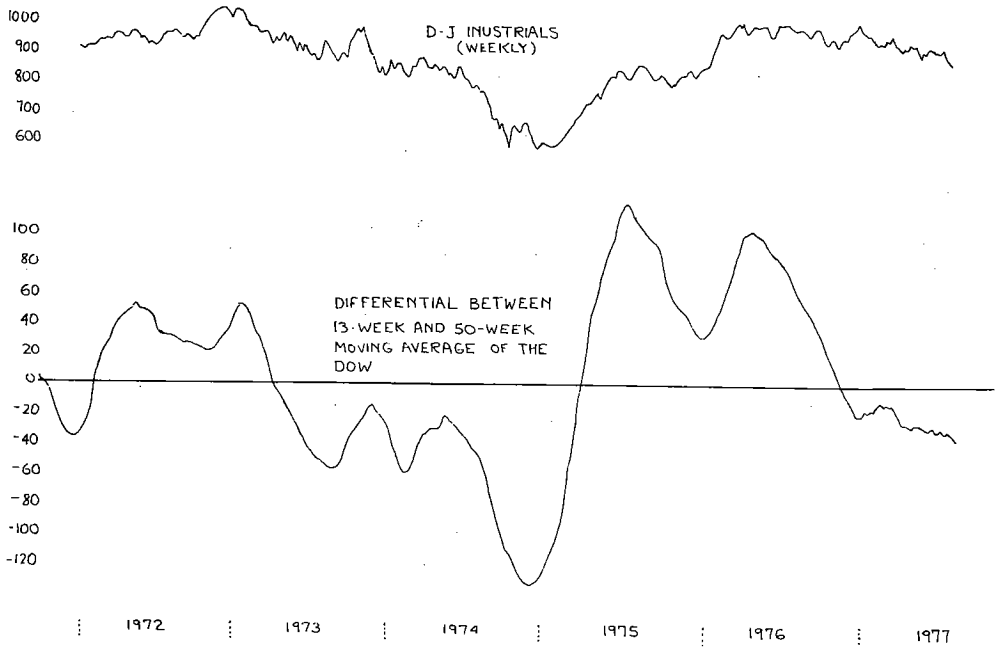
(1) It is bullish when the DL crosses above the zero level. It is bearish when the DL drops below the zero level.

(2) It is bullish when the DL is above zero and climbing. It is not necessarily bearish when the DL is above zero and declining. It is bearish when the DL is below zero and falling. It is not necessarily bullish when the DL is below zero and rising.

(3) The DL has a habit of forming double tops (as in 1972-73 and 1975-76). It also has a habit of forming double bottoms (as in 1973 and early 1974). Such structures usually imply that a reversal of market direction is in process.

(4) When a double bottom or a double top has formed, and the DL then breaks through that structure (as it did in mid-1974), then watch out, an "explosion" is coming in the direction of the breakthrough (in 1974 the DL broke through the 1973-74 double bottom, and the market collapsed).

(5) When the DL rises above 100 the Dow is overbought. When the DL drops below 100 the Dow is oversold. In such instances,



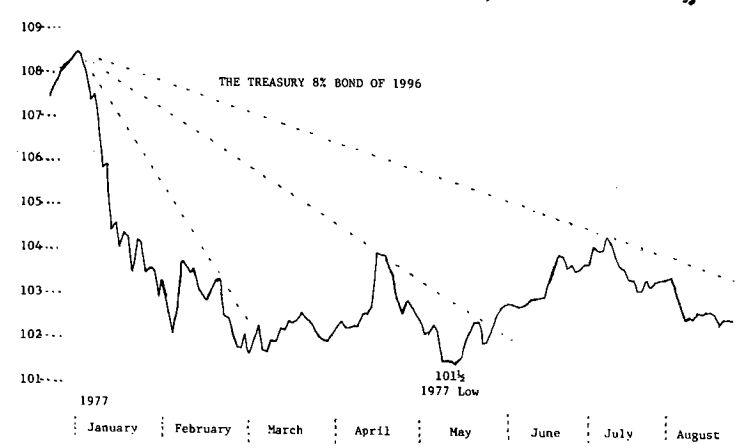
be prepared for a correction of the last trend (or a major reversal of the last trend).

Where are we now in terms of this study? As of last week the DL dropped to minus 36, lowest level of the entire decline. So far, there is nothing in this study to indicate that the Dow has bottomed out or that a major reversal is imminent. Not an encouraging study, but this study wasn't created to make us feel good, it was created as a "fail-safe."

BONDS: Last week *American Hospital Supply* came out with AA-rated bonds to mature in 2007 and yield 7.9%. Against this, you can currently buy a Government bond, for instance, the 8's of 1996, to yield 7.7%. In my opinion, this is a ridiculous comparison–the Government bond is simply too cheap. With fantastic liquidity and supreme safety, the 8 of 1996 is worth far more than a .2% spread on the Amer. Hospital bond.

What has happened, I believe, is that there has been a huge amount of *speculation* in Government bonds, and a lot of speculators have been caught on the wrong side of the bond market. They had to dump their Governments, and this forced Government prices down. Governments have been acting poorer than Industrial bonds on a relative strength basis.

I include my daily chart of the 8's of 1996, a widely followed Treasury bond. Note that from the 108½ high of January, there have been four downward thrusts in the bond, one in late-January,



one in late-February, one in early-May and the current rather lazy decline. The lowest thrust down was the one in early-May, at which time the bond hit a low for the year at 101½.

Note also that the bond has formed three "fan-lines" or declining trendlines. The fan-line formation often appears when a stock (or bond) is correcting. If the third fan-line is penetrated upside, the price movement often moves up smartly. My own feeling is that despite talk of "high interest rates," this (typical) bond has been acting very well indeed. All the "high interest rate" talk since May of this year has failed to take this bond to a new low below 101½.

This action is telling me that the bond market is discounting something besides Wall Street high interest rumors. My guess is that the bond is discounting recession and lower interest rates. Let's watch the 8's of 1996. A move above 103½ would take this bond above its third fan-line, and that would suggest (1) an economic recession, and (2) the big fooler, perhaps a sharp and unexpected drop in interest rates. At any rate, nothing in this chart makes me want to sell my long-term bonds.

NOTES & QUOTES: The oil crisis (at least temporarily) is turning into a massive oil glut. Gasoline stocks are currently 30% above the year ago level. Saudi Arabia may have to cut their production as much as 25%. There is even a chance of a buckling of the oil price structure, particularly if the trend of world business worsens.

* *

From Eliot Janeway's latest report: "*The Carter honeymoon is over–Carter is plunging at the polls just when the economy is eroding into a renewed slump. . . . Carter's performance has been disappointing and frustrating even with Lance there; with Lance gone–and like it or not, he is–the prospect is horrendous..... The Fed, with catastrophic timing, is pushing short-term interest rates up against the trend of an economy that is producing more liquidity than profit.*"

* *

In Letter 704, page 2, I included my Fibonacci studies, suggesting that there was a chance that the bottom of this correction could arrive around the middle of October. Last week a reader wrote to say that a full eclipse of the sun is to occur on October 12. Maybe after the darkness we'll see the light!

* *

The "General Motors rule" states that if four months go by **without** a new low in GM, it is bullish for the general market. Had GM been able to get past August 15 without recording a new 1977 low, GM followers would have had their bullish indication. So what happened? On August 11 GM broke below its 1977 low of 66 (accompanied by a new 1977 low in Ford). Was there ever anything meaner than the stock market!

* *

The July 27 break in both Averages was accompanied by a 9 to 1 (on the downside) ratio of points lost (based on studies by *Lowry's*, a statistical service I have followed for many years (350 Royal Way, Palm Beach, FL 33480). More important, such downside climaxes are *seldom isolated* affairs. They tend to come in series of 3 to 8. Conclusion: we will have more one-day "selling climaxes" before this reaction is over.

* *

I noticed in the August 3 issue of *Variety* that ***Son of Sam*** has already been registered as a film title–even before they caught Sam. The free enterprise sytem may be terribly money oriented, I thought to myself, but it sure can move.

* *

And speaking of moving, the Post Office is now at a new low as far as deliveries are concerned. Never, since I started this business, have I had so much trouble getting mail and sending mail. Curiously, I have heard few complaints from subscribers over the past few months regarding deliveries. I take it that we're all growing numb.

* *

I just spoke to a friend who has returned from his fifth trip to Europe in the past eight years. He was amazed at the results of his trip. I will repeat a few of his comments: *"My 12 year old son and I went to Athens, London, Paris. I couldn't believe the general atmosphere of kidnappings, violence, terrorism. My son was searched at the Dorchester, one of London's better hotels! In Rome and Paris everyone is trying to get their money to Switzerland or the US. Kidnappings are often 'staged,' and the ransom pay-off (arranged between the kidnapper's lawyer and your lawyer) may be used as a method of getting money out of the country.*

"I couldn't believe the prices in Paris and London. In Paris a room for two at a decent hotel ran $90 to $115 per night. A gourmet dinner (Paris) for five of us with wine was $400. How do the people in Paris live with these prices? Very poorly, in many cases! In London a room for two was $75 to $85 plus that damn 10% overcharge. We saw all kinds of plays and musical events, but the inflation is everywhere. In Athens we read a card in a restaurant that says 'all prices for breakfast, lunch and dinner will be raised 10% starting tomorrow.'

"Many Arabs in London, and often with their personal body-guards. The prices in Paris for rents are out of sight. A friend pays $2500 a month rent on Avenue Foche." How can they do it," I asked. *"They don't pay taxes. Everybody in Paris and Rome is trying to avoid taxes, and they do a good job of it. Oh yes, I forgot, a medium-sized laundry in London cost us $22. Lord, after that we bought a box of soap and did our own laundry in the room!*

"Things are changing rapidly in Europe. Everything is change. You can't trust the young at all. It's a strange generation. If they're under 25, you can't trust them. Unemployment is rising in Europe. There's a huge generation gap that is frightening everyone." Tickets to Europe, anyone?

* *

Elvis Presley has died at the age of 42. Elvis brought rock and roll to the Anglo Saxon white public (the blacks called it rhythm 'n blues and had it decades before Elvis). But Elvis also brought sex to the American public, and he brought it out in the open. It's still there–in the open.

Times have changed. When Elvis appeared on 1950's Ed Sullivan's program he was only allowed to be seen from the waist up! Today, you see more on a kiddie show. The sexual revolution has arrived, and it has given us many plusses and minuses. On the plus side we have access to knowledge about sex. And I happen to like girls in Bikinis rather than bloomers. On the minus side we have 200,000 innocent babies born a year, produced by teen-age unmarried mothers and often freaked-out or disappearing fathers.

The pendulum has swung from Puritanism to full permissiveness. Ultimately, society will have to find a sexual center, a middle ground. We are all striving to find our center, the middle between the poles in our emotions and our lives. We tend to see most things as too black or too white, too good or too bad, too wonderful or too tragic. The truth is usually nearer the center. Those same thoughts have often helped me with the stock market as well.

LATE NOTES: I must have stated a few dozen times over the past 18 months that the second phase of a bull market is the **most deceptive** phase. All right, look at what has happened. Reversing all the "normal sequences," the Dow topped out on September 21, 1976, **before** the bond market, **before** the A-D ratio, **before** the Utility Average. Thus, all those who waited for the "usual sequence of events" are caught "with their stocks down" in what could be a vicious correction. To make matters even more deceptive, the British market is hitting new four-year highs, even while the Dow touches a 19-month low (the British market normally tops out before the Dow).

It would seem that some kind of rally is overdue, but I still note an amazing amount of ***complacency*** among investors. The first rally (within an ongoing correction) should come amid **fear**–not complacency. It is striking to me to see only 700 odd lot shorts on a day (Aug. 16) when both Industrials and Transports hit new 1977 lows together!

There is always a temptation to jump in and play the occasional rallies, and many advisory publications (through ignorance or because they want to play genius) encourage people to buy for 20 and 40 point upside pops. I try to discourage my subscribers from engaging in that kind of damn foolishness. It's hard enough to get people in (and out) of the major moves, although those are the ones that make us (or save us) the big money. As far as scalping one or two week rallies, I strongly suggest that you refrain. I'll say it again, if you insist on "in-and-out" gambling, try Vegas. At least you can look at pretty girls (and handsome cowboys) while they're parting you from your assets.

I am asked about Utilities. During the **1957 second phase** correction the Utility Average dropped from 74.61 (May, 1957) to 52.10 (October, 1957) or about 16%. From the 1974 low of 57.93, the D-J Utility Average rose to a July 22, 1977 bull market high of 118.67. This was a rise of a bit over 100%. Often a *doubling* of the price structure (any price structure) can bring in corrective forces. The Utility Average has now broken a five-month rising trendline, and it is due to correct. How big a correction? I wouldn't think much worse than about 15%. Therefore, I would be surprised to see the D-J Utility Average break (at worst) much below 100.

STOCKS, COMMODITIES: Silver broke $4.40 on the down-side and looks weak to me. Gold looks all right to hold around or above 140, but (and I'm tired of saying this) I don't see gold going anywhere soon. A crack in the price of Arab oil would, I think, be bearish for all commodities. Obviously, I don't know if an oil price decline will come, but the oil is piling up and up.

Sure some stocks look good, but I hesitate to mention them because people will think I'm saying "buy" (which I'm not, not yet). At any rate, the crude oils and international oils are strong on a relative strength (RS) basis. The soft drink group has just turned bullish (the star is *Coca Cola*). Alas, three new groups have turned bearish in RS including Agricultural Machinery, Paper Containers and Specialty Machinery (the last includes *Joy Mfg., AMF, Harris Corp., Emhart*).

In Letter 704, page 4, I showed RS of the three major Averages plus the Financial Group. As of now, the *Transports* have completely ***broken down*** in relative strength. The Transports are probably more sensitive to forthcoming business trends than any other group, so I take it that they are providing us with a warning about business conditions coming up.

I have just re-read this Letter, and I hope I haven't put in too much heavy, technical material. I try to include what I'm thinking and also something for everyone, and that isn't easy. (Second thought: if technical analysis was easy, everybody'd be in it, and then it would be just about worthless).

NEXT MAILING: August 31st